Feb. 11 (Bloomberg) -- **U.S. Representative John Campbell** plans to offer legislation aimed at reducing the size of “too- big-to-fail” banks by requiring them to hold more capital including long-term debt.

Campbell’s bill comes as a number of lawmakers and regulators from both parties -- including Federal Reserve Governor Daniel Tarullo -- argue that the 2010 Dodd-Frank Act failed to curb the growth of large banks and express support for renewed efforts to limit the kind of systemic risk that fueled the 2008 financial crisis.

“Being big is not a problem in and of itself, but being big in a sense that it creates a competitive disadvantage and a systemic problem is a bad thing,” Campbell, a California Republican, said in an interview today with Bloomberg Government.
“If you want to stay big that’s fine, you can stay big. But it’s going to be rather expensive.”

Three of the four largest U.S. banks -- JPMorgan Chase & Co., Bank of America Corp. and Wells Fargo & Co. -- are bigger today than they were in 2007, heightening the risk of economic damage if one gets into trouble.

Banks typically fund their longer-term assets with short- term debt, making a profit on the interest-rate difference between the two. In a bank failure, stockholders are typically wiped out, and short-term debt can evaporate quickly as creditors refuse to renew commercial paper and short-term notes.

The bill by **Campbell** would require banks with at least $50 billion in assets to hold an additional layer of capital in the form of subordinated long-term bonds totaling at least 15 percent of consolidated assets. If an institution were to fail, the long-term bondholders would be guaranteed at no more than 80 percent of the face value of the debt. As a result, banks would face pressure to reduce their balance sheets.

Extra Capital

The extra layer of capital would be in addition to higher levels required as part of the Basel III international regulatory accords. The goal is to protect taxpayers from bailouts and equalize the competitiveness between large and small institutions, which face higher costs of capital, **Campbell** said.

Campbell also proposed using credit default swaps to help gauge when regulators should step in and assess a bank’s riskiness. Under his bill, if the price of a bank’s credit default swaps increases more than 50 basis points, the Fed would have to take steps to assess the banks’ soundness.

“We want this layer of debt to effectively be the canary in the coal mine,” Campbell said.

Volcker Rule

His legislation would also repeal Dodd-Frank's heightened standards for systemic institutions and its ban on proprietary trading, known as the Volcker rule. **Campbell** said that with additional capital requirements, a ban on proprietary trading would be unnecessary.

The Federal Reserve and the Federal Deposit Insurance Corp. are also weighing similar proposals. The two regulators are holding preliminary discussions on a rule that would require holding companies for the largest U.S. banks to maintain a minimum amount of long-term debt.

Tarullo said in a Dec. 4 speech in Washington that a minimum long-term debt rule "could lend greater confidence that the combination of equity owners and long-term debt holders would be sufficient to bear all losses at the firm."

Campbell said he plans to introduce his bill tomorrow.